FILE COPY

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1949

Supreme Court, U.
FILED
NOV 12 1949
CHARLES ELMORE CRO
CLE

No. 453

JOE SHOONG,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

and

ROSE SHOONG,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CONSOLIDATED PETITION FOR WRIT OF CERTIORARI to the United States Court of Appeals for the Ninth Circuit and BRIEF IN SUPPORT THEREOF.

NAT SCHMULOWITZ,
PETER S. SOMMER,
SIDNEY F. DEGOFF,
GAVIN MCNAB, SCHMULOWITZ, AIKINS, WYMAN & SOMMER,
625 Market Street, San Francisco 5, California,
Attorneys for Petitioners, Joe Shoong and Rose Shoong.

BLEED THROUGH

POOR COPY

Subject Index

Page

Consolidated Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit..... 1

I.

A summary and short statement of the matter involved..... 2

II.

The basis upon which it is contended that this court has jurisdiction to review the judgment of the Court of Appeals for the Ninth Circuit..... 7

A. Statutory provisions 7

B. Rule of court 7

C. Date of judgment 8

III.

The questions presented 8

IV.

Special and important reasons relied upon for the allowance of the writ 14

Petitioners' Brief in Support of Consolidated Petition for Writ of Certiorari 19

A. Opinions of the courts below 19

B. Jurisdiction 20

C. Statement of the case 20

D. Specification of errors 21

E. Summary of the argument 24

F. Argument 25

1. Under the provisions of the Internal Revenue Code, petitioners are entitled to amortize or deduct premiums paid by them upon the bonds purchased..... 25

2. The right to amortize or deduct the aforementioned premium rests not only upon the letter of the Code

Page

provisions, but also upon the obvious intent of the basic statute 28

3. The statutory right is recognized in the regulations issued by the commissioner in pursuance of the Code section 31

4. Section 125 of the Internal Revenue Code declares unambiguously the precise rules for the determination of the existence of bond premium and the amount thereof 32

5. Since the bond premium amortized or deducted by petitioners is squarely within the provisions of sections 23(v) and 125 of the Revenue Code, the Appellate Court's statement that deductions are matters of "legislative grace" and "are to be strictly construed against the taxpayer" are not applicable to this case 37

6. The Court of Appeals erroneously adopted the commissioner's strained construction of the statutory language with respect to limiting the amortizable bond premium to the interest factor alone..... 38

7. The Court of Appeals erroneously adopted the commissioner's esoteric concept of "true bond premium" which has been previously rejected by this court.... 40

8. The Tax Court having held that the amount above par paid for the bonds was bond premium the Court of Appeals was not at liberty to draw a contrary inference that such amount was paid solely for a stock purchasing covenant 42

9. The amount of the bond premium amortized by each of the petitioners respectively shows substantial if not exact compliance with the terms of Section 125 of the Code, and is therefore fully deductible under Section 23(v) thereof 43

10. The decision of the Court of Appeals is a judicial attempt to remodel legislation and trespasses beyond the judicial and upon the legislative process..... 46

G. Conclusion 48

BLEED THROUGH POOR COPY

Table of Authorities Cited

Cases	Pages
Algoma Plywood etc. Co. v. Wisconsin Employment Relations Board, 93 L. Ed. Adv. Op. 541	30
Armstrong v. Commissioner (CCA 10), 143 F. (2d) 700	43
Barnhill v. Commissioner (CCA 4), 148 F. (2d) 913	42
Barr v. United States, 324 U. S. 83, 65 S. Ct. 522, 89 L. Ed. 765	31
Boehm v. Commissioner, 326 U. S. 287, 66 S. Ct. 120, 90 L. Ed. 78	42
Broadcasting etc. Inc. v. Federal Communications Commission (Dist. of Col.), 171 F. (2d) 1007	29
Brotherhood of R. R. Trainmen v. Baltimore etc. R. R. Co., 331 U. S. 519, 67 S. Ct. 1387, 91 L. Ed. 1646	10, 11, 30
Browder v. United States, 312 U. S. 335, 61 S. Ct. 599, 85 L. Ed. 862	31
Burnet v. Thompson Oil & Gas Co., 283 U. S. 301, 51 S. Ct. 418, 75 L. Ed. 1049	37
Caminetti v. U. S., 242 U. S. 470, 61 L. Ed. 442, 37 S. Ct. 192	36
Commissioner v. Caulkins, 144 F. (2d) 482 (CCA 6)	47
Commissioner v. Columbia River P. Mills (CCA 9), 126 F. (2d) 1009	41
Commissioner v. Eldridge (9th Cir.), 79 F. (2d) 629	45
Commissioner v. Korell, 176 F. (2d) 152	11, 20, 32, 36
Commissioner v. Midland Elec. Coal Corp. (CCA 7), 152 F. (2d) 171	42
Commissioner v. Proctor Shops, Inc. (CCA 9), 82 F. (2d) 792	41
Commissioner v. Riggs (CCA 3), 78 F. (2d) 1004	37
Commissioner v. T. R. Miller Mill Co. (CCA 5), 102 F. (2d) 599	41
Commissioner v. Wodehouse, 93 L. Ed. Adv. Ops. 1043	8
Consolidated Goldacres Co. v. Commissioner (CCA 10), 165 F. (2d) 542	39
Corona Coal Co. v. United States, 263 U. S. 537, 68 L. Ed. 431, 44 S. Ct. 156	47

Pages

Deputy v. DuPont, 308 U. S. 488, 60 S. Ct. 363, 84 L. Ed. 416 8
Dobson v. Commissioner, 320 U. S. 489, 64 S. Ct. 239, 88 L. Ed. 248 43

Ebert v. Poston, 266 U. S. 548, 45 S. Ct. 188, 69 L. Ed. 435.. 47
Elmhurst Cemetery Co. v. Commissioner, 300 U. S. 37, 57 S. Ct. 324, 81 L. Ed. 491 42
Ex parte Collett, 93 L. Ed. Adv. Op. 901..... 30

Federal Savings & Loan Ins. Corp. v. Edison Savings & Loan Ass'n (N.Y.), 83 F. Supp. 1007 36
Forrestal v. Commissioner (2d Cir.), 120 F. (2d) 223..... 37
Forstmann v. Rogers, 128 F. (2d) 126 (CCA 3)..... 47

Gemsco, Inc. v. Walling, 324 U. S. 244, 89 L. Ed. 921, 65 S. Ct. 605 30
Gould v. Gould, 245 U. S. 151, 38 S. Ct. 53, 62 L. Ed. 211... 27
Gregory v. Helvering, 293 U. S. 465, 55 S. Ct. 266, 79 L. Ed. 596 45

Hall v. Commissioner (CCA 10), 150 F. (2d) 304..... 42
Hecht v. Malley, 265 U. S. 144, 44 S. Ct. 462, 68 L. Ed. 949.. 27
Helvering v. City Bank etc. Co., 296 U. S. 85, 80 L. Ed. 62, 56 S. Ct. 70 36
Helvering v. Northwest Steel Mills, 311 U. S. 46, 61 S. Ct. 109, 85 L. Ed. 29 8

In re Borchert (Cal.), 47 F. Supp. 387..... 36
In re Korell, 10 T. C. 1001.....20, 28
Iselin v. United States, 270 U. S. 245, 70 L. Ed. 566, 46 S. Ct. 248 47

Jones v. Commissioner (CCA 9), 103 F. (2d) 681..... 42
Jones, Collector of Internal Revenue v. Crosswell (4th Cir.), 60 F. (2d) 827 27

Koster v. Turchi, 173 F. (2d) 605 (CCA 3)..... 47

Matson Navigation Co. v. United States, 284 U. S. 352, 76 L. Ed. 336, 52 S. Ct. 152..... 47
McKeown v. So. Cal. etc. Forwarder (Cal.), 52 F. Supp. 331; affirmed 148 F. (2d) 840; cert. denied, 326 U. S. 736, 90

BLEED THROUGH POOR COPY

Pages

L. Ed. 439, 66 S. Ct. 46; rehearing denied, 326 U. S. 808, 90 L. Ed. 493, 66 S. Ct. 138 37
McClain v. Commissioner, 311 U. S. 527, 85 L. Ed. 319, 61 S. Ct. 375 46
Midland v. Ickes (8th Cir.), 125 F. (2d) 618 27
Murchie v. Delaney (Mass.), 82 F. Supp. 176 ..... 12, 45

New Colonial Ice Co. v. Helvering, 292 U. S. 435, 54 S. Ct. 788, 78 L. Ed. 1348 37
National Carbide v. Commissioner, 93 L. Ed. Adv. Op. 634, affirming Commissioner v. National Carbide, 167 F. (2d) 304 (CCA 2) 45

Old Colony R. Co. v. Commissioner, 284 U. S. 552, 52 S. Ct. 211, 76 L. Ed. 484 ..... 39, 41
Osaka etc. Line v. U. S., 300 U. S. 98, 81 L. Ed. 532, 57 S. Ct. 356 37

Packard Motor Car Co. v. N.L.R.B., 330 U. S. 485, 67 S. Ct. 789, 91 L. Ed. 1040 ..... 10, 11, 30
Puerto Rico v. Shell Co., 302 U. S. 253, 58 S. Ct. 167, 82 L. Ed. 235 31

Raffold Process Corp. v. Commissioner (CCA 1), 153 F. (2d) 168 42

Sampson Tire etc. Corp. v. Rogan (9th Cir.), 136 F. (2d) 345 45
Stokes v. Commissioner, 124 F. (2d) 335 (CCA 3) 47
Superior Oil Co. v. Mississippi, 280 U. S. 390, 50 S. Ct. 169, 74 L. Ed. 504 45

Thompson v. U. S., 246 U. S. 547, 62 L. Ed. 876, 38 S. Ct. 349 36
Tyson v. Commissioner (CCA 8), 146 F. (2d) 50 42

United States v. Cooper Corp., 312 U. S. 600, 85 L. Ed. 1071, 61 S. Ct. 742 47
U. S. v. Goelet, 232 U. S. 293, 34 S. Ct. 431, 58 L. Ed. 610 ... 12
United States v. Goldenberg, 168 U. S. 95, 18 S. Ct. 3, 42 L. Ed. 394 47
United States v. Merriam, 263 U. S. 179, 44 S. Ct. 69, 68 L. Ed. 240 27
U. S. v. Pan American etc. (9th Cir.), 55 F. (2d) 758 27

Pages

United States v. Rice, 327 U. S. 742, 66 S. Ct. 835, 90 L. Ed. 982 30

Wabash R. R. Co. v. U. S. (8th Cir.), 178 F. 5..... 26

Codes and Statutes

Internal Revenue Code, Section 1141 (a) (Title 26, USCA, 53 Stat. 164, amended October 21, 1942, 56 Stat. 957, and amendment of June 25, 1948, C. 646, Section 36, 62 Stat. 991) 7

Judicial Code (Judicial Code and Judiciary, Chapter 646—Public Law 773, Title 28, United States Code Judiciary and Judicial Procedure):
Section 1254 7
Section 2101 8

Revenue Act of 1942, Section 125.....
.....9, 11, 14, 21, 22, 23, 24, 25, 28, 29, 31, 32, 33, 35, 38, 43, 44
Revenue Code, Section 23(v) 21, 24, 25, 28

Miscellaneous

Accounting Principles, 4th Ed., Howard S. Noble, Southwestern Publishing Co., Cincinnati, Ohio, 1945, p. 447.... 39
Advanced Accounting, W. A. Patton, The Macmillan Company, N. Y. 1941, pp. 196-7, 614 39
American Business Practice, The Ronald Press Company, N. Y. 1931, p. 1653 39

Basic Accounting Principles, Earl L. Saliers, Richard D. Irwin, Inc., Chicago, 1947, pp. 508-9..... 39

Financial Handbook, 3rd Ed., Jules I. Bogen, The Ronald Press Company, N. Y. 1948, pp. 1210-11 39

H. Rep. No. 2333, 77th Cong., 2d Sess., p. 79 (1942-2 CB 372, 432) 34, 38, 40
H. Rep. No. 2333, 77th Cong., 2d Sess., p. 80 (1942-2 CB 372, 433-434) 28

Revised Rules, Supreme Court, 28 USCA, Rule 38, Subdivision 5 ..... 7, 8

BLEED THROUGH POOR COPY

Pages

S. Rep. No. 1631, 77th Cong., 2d Sess., p. 93 (1942-2 CB 504, 574-575) 34, 40

S. Rep. No. 1631, 77th Cong., 2d Sess., p. 94 (1942-2 CB 504, 576) 28

Treasury Regulations 111:

Sections 29.125-1-2-3-5 9

Section 29.125-5 ..... 23, 31, 32, 34

BLEED THROUGH POOR COPY

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1949

No.

JOE SHOONG,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

and

ROSE SHOONG,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CONSOLIDATED PETITION FOR WRIT OF CERTIORARI
to the United States Court of Appeals
for the Ninth Circuit.

To the Honorable Fred M. Vinson, Chief Justice of the United States, and to the Honorable Associate Justices of the Supreme Court of the United States:

JOE SHOONG and ROSE SHOONG jointly respectfully petition the Court for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit, to review a judgment of said Court entered on September 9, 1949. In support of this petition, the petitioners aver:

I.

A SUMMARY AND SHORT STATEMENT OF THE MATTER INVOLVED.

This consolidated petition concerns alleged deficiencies asserted by the Commissioner of Internal Revenue (hereinafter, for purposes of brevity, referred to merely as "Commissioner") in respect to the petitioners' personal income taxes for the year 1944.

While there are two separate cases affecting the petitioners, respectively, they were consolidated both in the Tax Court (R. 20) and in the Court of Appeals (R. 52) for briefing, hearing, argument and decision.

The amount in controversy in the case of Joe Shoong is $58,441.99 (R. 8) and in the case of Rose Shoong it is $61,841.00 (R. 16, 18). These amounts were originally determined by the Commissioner to be deficiencies against the petitioners. On review the Tax Court ruled favorably to the petitioners. (R. 31.) The Court of Appeals has reversed the ruling of the Tax Court. (R. 72.)

The question involved is whether the taxpayers could or could not take as a deduction in computing their 1944

BLEED THROUGH POOR COPY

net taxable income the amortization of premiums paid by them in the purchase in 1944 of American Telephone and Telegraph Company, fifteen-year, three per cent, convertible debenture bonds dated September 1, 1941, and due September 1, 1956.

The Commissioner and the Court of Appeals declared that the taxpayers could not take the deduction. The Tax Court declared that the taxpayers could take the deduction.

The facts are for the most part set forth in a Stipulation received in evidence before the Tax Court as "Exhibit A-1." (R. 20.) The following short statement embraces all the pertinent facts.

The petitioners are husband and wife, and reside in Oakland, California. They filed separate returns for the calendar year 1944 with the Collector of Internal Revenue for the First District of California on a community property basis. (R. 20-21.)

With respect to Joe Shoong, the record discloses that on June 21, 1944, he purchased bonds at a total cost of $606,541.66, which included the cost of the bonds, the commission and the accrued interest thereon. (R. 21.) In his income tax return for 1944, he reported adjusted gross income of $104,304.58 and deductions of $97,533.76, which latter amount included a claim of $81,879.94 for amortization of bond premium and accordingly he reported a net income of $6,770.82. (R. 21.)

With respect to Rose Shoong, the record shows that she purchased on June 26th and 27th, 1944, bonds for the aggregate amount of $610,501.67, which included the

principal amount thereof at cost, plus the commission and accrued interest. In her income tax return for 1944 she reported adjusted gross income of $100,927.43 and deductions of $96,325.84, which latter figure included a claim of $85,607.29 as amortization of bond premium, and reported a net income of $4,691.59. (R. 22.)

The bonds were issued under an indenture, a copy of which is in the record (R. 23), and it appears therefrom that the bonds were convertible into capital stock of the issuing company at any time after January 1, 1942, and before January 1, 1954, at the conversion price of $140.00 per share, subject to certain adjustments. (R. 21.)

The terms of conversion of the bonds were stated as follows (R. 54, "Exhibit H"):

> "Terms of Conversion of Debenture Bonds into Capital Stock
>
> "At any time after January 1, 1942 but not later than December 31, 1954, unless previously called for redemption, the debenture bonds will be convertible into capital stock of the company. The conversion price will be $140 per share, payable by surrender of $100 principal amount of debenture bonds and payment to the company of $40 in cash for each share of capital stock to be issued upon conversion. The conversion price, the number of shares issuable upon conversion and the amount of cash per share payable upon conversion will be subject to adjustment as provided in the indenture.
>
> "Surrender of debenture bonds (with unmatured coupons attached) for conversion and payment of cash required upon the conversion is to be made at

BLEED THROUGH POOR COPY

the office of the treasurer of the company, 195 Broadway, New York, N. Y."

The company's option to redeem the bonds in question was expressed as follows (R. 54—"Exhibit H"):

The company had the option to redeem all or from time to time any part of the redemption bonds on or after September 1, 1942, at the following redemption prices (expressed in percentage of the principal amount), together with accrued interest to the date of redemption ("Exhibit H" pages 28-29):

To and including August 31, 1944, 107%;

Thereafter to and including August 31, 1948, 104%;

Thereafter to and including August 31, 1953, 102%;

Thereafter, 100%.

Notice of the exercise of the right to redeem the bonds was required to be published at least four times, the first publication to be not less than thirty days and not more than ninety days before the date fixed for redemption. (R. 54—"Exhibit H.")

The entire issue of the bonds was called for redemption under the provisions of the bond indenture for payment on September 1, 1947, at 104% plus interest. (R. 23.)

The bonds purchased by Joe Shoong and Rose Shoong were not part of their stock in trade, or includable in any inventory of theirs at the close of the taxable year, or held by them primarily for sale to customers in the ordinary course of their trade or business. They did not,

during the calendar year 1944, sell any of the bonds purchased by them, nor did they exercise their privilege of converting said bonds into the capital stock of the company. (R. 28-29.)

In the deficiency notices which were sent to the petitioners by the Commissioner, he advised each of them that the deductions which each claimed for amortization of bond premium were disallowed "since it is held that the amount does not represent amortizable bond premium." He further declared "that the consideration represents the value of the right to convert the bonds into capital stock of the company." (R. 9, 29, 17-18, 30.)

Thereafter, both Joe Shoong and Rose Shoong filed their petitions before the Tax Court for a re-determination of the deficiency set forth by the Commissioner in his notices of deficiency (R. 4, 12), and in due course the Tax Court made its Memorandum of Findings of Fact and Opinion (R. 31) and rendered its decision favorable to the petitioners. (R. 37.)

Thereafter, the Commissioner filed his petition for review with the Court of Appeals (R. 39, 43) to review the decision entered by the Tax Court, and thereafter the Court of Appeals disposed of the matter as hereinbefore set forth.

BLEED THROUGH POOR COPY

II.

THE BASIS UPON WHICH IT IS CONTENDED THAT THIS COURT HAS JURISDICTION TO REVIEW THE JUDGMENT OF THE COURT OF APPEALS FOR THE NINTH CIRCUIT.

A. Statutory Provisions.

This Court has jurisdiction to issue a Writ of Certiorari and review the Judgment in question, under Section 1254 of the Judicial Code (Judicial Code and Judiciary, Chapter 646—Public Law 773, Title 28, United States Code Judiciary and Judicial Procedure), which provides in Subdivision 1 thereof that cases in the Court of Appeals may be reviewed by the Supreme Court by Writ of Certiorari granted upon the petition of any party to any civil case after the rendition of judgment or decree.

It is further provided under Section 1141 (a), Internal Revenue Code, (Title 26, USCA, 53 Stat. 164, amended October 21, 1942, 56 Stat. 957, and the amendment of June 25, 1948, C. 646, Section 36, 62 Stat. 991) that the judgment of any Court of Appeals reviewing a decision of the Tax Court, shall in turn be subject to review "by the Supreme Court of the United States upon certiorari in the manner provided in Section 1254 of Title 28 of the United States Code."

B. Rule of Court.

It is also provided under Subdivision 5(b) of Rule 38 of the Revised Rules of the Supreme Court that among the reasons which will be considered for the granting of a review on Writ of Certiorari is where one Court of

Appeals has rendered a decision in conflict with the decision of another Court of Appeals on the same matter. (Revised Rules, Supreme Court, 28 USCA, Rule 38, Subdivision 5; *Commissioner v. Wodehouse*, 93 L. Ed. Adv. Ops. 1043, 1060; *Deputy v. DuPont*, 308 U.S. 488, 490, 500, 60 S. Ct. 363, 84 L. Ed. 416; *Helvering v. Northwest Steel Mills*, 311 U.S. 46, 61 S. Ct. 109, 85 L. Ed. 29.)

C. Date of Judgment.

The decision of the Court of Appeals sought to be reviewed was rendered on September 9, 1949. Petitioners did not file a petition for a rehearing. This petition for Writ of Certiorari, the brief in support thereof, and the record in said cause, are being filed in this Court within ninety days after the entry of the judgment by the Court of Appeals, all in compliance with Section 2101, Judicial Code and Judiciary, Ch. 646—Public Law 773, Title 28, U.S. Code, Judiciary and Judicial Procedure.

III.

THE QUESTIONS PRESENTED.

A.

The basic question presented is whether the Tax Court, on the one hand, or the Court of Appeals, on the other hand, properly determined that the petitioners could or could not take as a deduction, in computing their 1944 net taxable income, the amortization of the premiums paid by them in the purchase of 1944 of the bonds above referred to.

BLEED THROUGH POOR COPY

B.

When Congress enacted the Revenue Act of 1942, and particularly Section 125 thereof, did it not provide in unambiguous and unequivocal language that when bonds of the character involved in this proceeding are purchased at a premium, the purchasers thereof are entitled to amortize or deduct the premium paid by them upon the bonds so purchased?

C.

Do the House and Senate Committee Reports in connection with the Revenue Act of 1942 (which added Sections 23 (v) and 125 to the Code) confirm the legislative intent and purpose of Congress?

D.

Do the Treasury Regulations (111, Sections 29.125-1, -2, -3, and -5), issued by the Commissioner in pursuance of the directions contained in Section 125 of the Code, recognize the substantial right of the taxpayer to amortize bond premium, as was done by the petitioners?

E.

Was the Tax Court sound in its interpretation of the Commissioner's Regulations, when it *unanimously* declared that Section 29.125-5 contained a restriction unauthorized by Congress, and therefore said portion of the Regulation "appeared to be a gratuitous addition" by the Commissioner "not founded upon statutory language and directly in conflict with its legislative history"?

F.

Is it not well established that the intention of Congress is to be sought primarily in the language used, and where this language is unambiguous and unequivocal, and expresses an intention reasonably intelligible and plain, must it not be accepted by the Courts, without modification, by resort to construction or conjecture?

G.

Are the Courts at liberty to go in search of legislative meaning where the language of the statute is so plain as to need no construction, or even to refer to Committee Reports when there can be no doubt of the meaning of the words used?

H.

Where statutory language appears to be clear and unambiguous, is it not unnecessary to resort to legislative history or artificial canons of construction? (*Packard Motor Car Co. v. N. L. R. B.*, 330 U. S. 485, 492, 67 S. Ct. 789, 91 L. Ed. 1040; *Brotherhood of R. R. Trainmen v. Baltimore etc. R. R. Co.*, 331 U. S. 519, 528, 529, 67 S. Ct. 1387, 91 L. Ed. 1646.)

I.

Have not the Commissioner of Internal Revenue and the Court of Appeals attempted to create ambiguity by dissecting parts and words of the statute under consideration, and then attempted to apply various canons of construction, and has not the Supreme Court declared that such procedure cannot create doubt in a statute where none already exists? (*Packard Motor Car Co. v. N.L.R.B.*,

BLEED THROUGH POOR COPY

supra; *Brotherhood of R. R. Trainmen v. Baltimore etc. R. R. Co.,* supra.)

J.

Are the Courts permitted, in effect, to superimpose their own idea of legislative policy (through the guise of the judicial function) upon legislative intent when already clearly expressed by Congress, even though a specific Court or some of its members may believe that the operation of a specific statute produces an unreasonable result that is characterized as "garish"? If in truth such should be the result, should not Congress itself act, and is not Congress the exclusive branch of Government that may act to remedy such a situation?

K.

Has not the Court of Appeals engaged in "a judicial attempt to remodel legislation," and has not the Court of Appeals trespassed "beyond the judicial and upon the legislative process?" See *Commissioner v. Korell,* 176 F. 2d 152.

L.

Do not the undisputed facts in this case disclose that the amount of the bond premium amortized by each of the petitioners was in exact compliance with the terms of Section 125 of the Code, and that said amount was therefore fully deductible under Section 23 (v) thereof?

M.

Is it not the duty of the Courts *not* to construe the words used by Congress to cover the fullest possible extent of its power to tax, when it in fact uses words which in

their usually accepted meaning give a lesser scope to the tax? (*U. S. v. Goelet*, 232 U. S. 293, 34 S. Ct. 431, 58 L. Ed. 610; *Murchie v. Delaney* (Mass.), 82 F. Supp. 176, 179.)

N.

Is it likely that the Tax Court, consisting of sixteen members, one member of which wrote a "carefully reasoned opinion," which was reviewed "by the whole Court" *without any dissent*, would become a party to a gross error in construing Congressional legislation in such a manner as would produce a result more than "garish" in character? (See Opinions in *Commissioner v. Korell*, and *Commissioner v. Shoong*, R. 60.) How much more impressive does the opinion by the Tax Court become when it is subjected to careful scrutiny and analytical review by three members of a Court of Appeals, who in turn declare *without dissent* that the opinion of the Tax Court "fully meets the issues presented by the Commissioner" and that it includes in addition to the facts, the statutory provisions and Treasury Regulations, "certain of the Committee Reports explaining the statutory provision when it was adopted." (*Commissioner v. Korell.*) We thus have nineteen judicial minds declaring that petitioners complied with Congressional intent, as against which we have in this case three judicial minds declaring that the petitioners did not comply with Congressional intent.

O.

When the Courts are called upon to construe Congressional legislation, clearly worded, is greater weight to be

BLEED THROUGH POOR COPY

accorded to a statement made before the Ways and Means Committee of the House by the Tax Advisor to the Secretary of the Treasury (as did the Court of Appeals for the Ninth Circuit), or to the House and Senate Committee Reports, which clearly declare: *"In the case of a convertible bond, if the option to convert the bond into stock rests with the owner of the bond, the bond is within the purview of this section,"* (as did the Tax Court in both the *Korell* and *Shoong* cases, and as did the Court of Appeals for the Second Circuit in the *Korell* case)?

P.

When the Courts are called upon to construe a tax statute, assuming for purposes of argument only that some doubt exists with respect to the scope and meaning of the statute, is it not the duty of the Courts to resolve such doubt in favor of the taxpayer?

Q.

If Congress appears to have made a choice of language which fairly brings the situation affecting the petitioners within the statute under consideration, is it not unimportant that the particular application to the situation such as confronts the petitioners may not have been contemplated by Congress?

IV.

SPECIAL AND IMPORTANT REASONS RELIED UPON FOR THE ALLOWANCE OF THE WRIT.

A.

The Court of Appeals for the Ninth Circuit has rendered a decision in direct and categoric conflict with the decision by the Court of Appeals for the Second Circuit in *Commissioner v. Korell*, where the facts relate to a deduction for amortization of bond premium on bonds of the same issue, and the facts are substantially the same as those involved in this case.

B.

The Court of Appeals has decided an important question of Federal law relating to the Internal Revenue Code, and affecting our national revenue from individual income tax, and affecting numberless taxpayers, which has not been, but should be, settled by this Court.

C.

The Court of Appeals

1. Has nullified Congressional legislation adopted as part of the Revenue Act of 1942, admittedly specifically designed to correct inequitable results in the taxation of income from bonds; and

2. Has nullified Treasury Regulations 111 issued in pursuance of the directions contained in Section 125 of the Internal Revenue Code, and has thereby decided the primary and collateral Federal questions involved in a way probably in conflict with the applicable decisions of this Court.

BLEED THROUGH POOR COPY

D.

The Court of Appeals by its judicial attempt to remodel Congressional legislation has clearly trespassed beyond the judicial and upon the legislative process, and by reason thereof has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

E.

This Court may well take judicial notice of the probable fact that transactions of the form and substance engaged in by Joe Shoong, Rose Shoong and Christian W. Korell were likewise engaged in by many other investors, both with respect to bonds of the American Telephone and Telegraph Company of the same issue as involved herein, as well with respect to bonds of other corporations in the United States having similar features of convertibility into common stock.

As stated by the Court of Appeals for the Second Circuit in *Commissioner v. Korell*, "the obvious advantage taxwise of transactions of this form might make such convertible bonds all the rage of security markets." Under such circumstances, there must be taxpayers numbering legion who either have refrained from paying tax deficiencies asserted by the Commissioner, or who have paid such taxes under protest and have claims pending for refund, all in reliance upon the decision in *Commissioner v. Korell*, and whose liability to the United States for alleged unpaid taxes, or whose right to refund thereof, is now placed in doubt by the decision in this case.

As pointed out in Prentice-Hall Tax Service (Section 12466 (b), page 12321), the ruling in both the *Korell* and *Shoong* cases "is of wide interest to both investors generally and of special importance to investors who held American Telephone and Telegraph Company three per cent debenture bonds that were convertible into capital of that company."

The Commissioner, in the *Korell* case, has also filed a petition for writ of certiorari to this Court (No. 384), in which petition he points out as one of the reasons why this Court should grant his petition is that,

> "The question here involved is also a question of general importance in the administration of the Revenue Acts which has not, but which should be, resolved by this Court. The issuance of debentures or other evidences of indebtedness permitting conversion, at the option of the holder, into stock of the issuing corporation is not unusual in corporate finance. Hence the question presented is one of general and continuing importance."

As an illustration of this wide interest, we refer to special articles which have appeared in the public press, particularly an article by a financial writer which appeared in the financial page of the San Francisco News on September 30, 1949, and a similar article prepared by Godfrey N. Nelson, a well-known financial writer, which appeared in the New York Times for September 25, 1949.

WHEREFORE, your petitioners respectfully pray that a Writ of Certiorari be issued out of and under the seal of the Supreme Court of the United States, directed to the United States Court of Appeals for the Ninth Circuit, com-

BLEED THROUGH POOR COPY

manding said last mentioned Court to certify and send to the above entitled Court for its review and determination a full and complete transcript of the record and proceedings in the case entitled on its docket: "Commissioner of Internal Revenue, Petitioner, v. Joe Shoong, Respondent, and Commissioner of Internal Revenue v. Rose Shoong, Respondent," No. 12136, and that this Court review and decide the questions presented according to law, and reverse the decree of the United States Court of Appeals for the Ninth Circuit entered in said cause, and that your petitioners may have such other and further relief as to this Court may seem meet and just and in conformity with law. Your petitioners will ever pray.

Dated, San Francisco, California,
November 7, 1949.

NAT SCHMULOWITZ,
PETER S. SOMMER,
SIDNEY F. DEGOFF,
GAVIN MCNAB, SCHMULOWITZ, AIKINS, WYMAN & SOMMER,

Attorneys for Petitioners, Joe Shoong and Rose Shoong.

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1949

No.

JOE SHOONG,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.
and
ROSE SHOONG,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONERS' BRIEF IN SUPPORT OF CONSOLIDATED PETITION FOR WRIT OF CERTIORARI.

A. OPINIONS OF THE COURTS BELOW.

The Tax Court opinion is set forth in 7 T. C. M. 367 (Dec. 16453 (M)). (See also R. 31-9.) For the opinion of the Court of Appeals see R. 60 *et seq.*

The Tax Court opinion *In re Korell* is reported in 10 T. C. 1001, while *Commissioner v. Korell* is reported in 176 F. (2d) 152 (CCA 2).

The Court of Appeals for the Ninth Circuit has rendered a decision directly in conflict with the decision of the Court of Appeals for the Second Circuit involving the same question. The two cases raise the same important question, namely, whether a taxpayer is entitled to the deduction for amortization of bond premium representing the cost of the same issue of convertible debenture bonds over the amount payable on call date prior to maturity, pursuant to the provisions of the statute. The Tax Court in both the *Shoong* and *Korell* cases held that the "amortizable bond premium" was deductible under the statute, even though the premium paid was due, in part, to the stock purchase option contained in the convertible covenant. The Court of Appeals for the Second Circuit (*Korell* case) affirmed the decision of the Tax Court, whereas the Court of Appeals for the Ninth Circuit (*Shoong* case) reversed it.

B. JURISDICTION.

The grounds on which the jurisdiction of the Supreme Court of the United States is invoked are set *supra* at page 7.

C. STATEMENT OF THE CASE.

The facts are set forth *supra* at page 2.

BLEED THROUGH POOR COPY

D. SPECIFICATION OF ERRORS.

The Court of Appeals erred:[1]

1. In holding that the purchase price paid above par for the bonds was paid solely for the stock purchase covenant.

2. In finding that Congress did not intend that the amount paid for the bonds over par should be the premium designated as "amortizable bond premium."

3. In finding that the amortizable bond premium which Congress intended as an allowable tax deduction is that part of the premium or purchase price paid above the bond par value which arises from the interest return alone.

4. In deciding that the amortizable bond premium for which a tax deduction is provided in the tax statute is not the premium paid in part for the convertible feature of the bond.

5. In basing its determination of congressional intent with respect to the tax statute upon the profit derived by the taxpayer from his investment.

6. In holding that the tax statute does not define "amortizable bond premium," when Section 125 (b) (1) provides that the "amount of bond premium" shall be determined with reference to the cost and the "amount payable on maturity or on an earlier call date," and Section 125 (b) (2) provides that "the amortizable bond

[1]Unless otherwise indicated, all references to "Tax Statute" relate to both Sections 23 (v) and 125 of the tax code enacted as part of the Revenue Act of 1942.

premium of the taxable year shall be the amount of the bond premium attributable to such year."

7. In finding that the meaning of the phrase "amortizable bond premium" must be ascertained not only from a consideration of Section 125 as a whole, but also in connection with the Report of the Congressional Committee concerning the purpose of the legislation, although the language of that section plainly and unequivocally provides that bonds of the character involved in this proceeding purchased at a premium may be amortized.

8. In construing the statement of the tax adviser to the Secretary of the Treasury with respect to amortization of bond premium as being limited only to that portion of bond premium attributable to the interest factor alone.

9. In finding that the amount of the interest played no part in determining the purchase price of the bonds above par.

10. In finding that the definition of a bond in the tax statute limits the amortization of bond premium to the interest factor alone.

11. In excluding from the definition of bond (section 125 (d)) interest bearing bonds of the character here involved.

12. In holding that the provision for amortization of bond premium grants a deduction for capital loss on a bond inconsistent with all the other provisions of Section 23 of the tax statute.

13. In finding that its own interpretation of the phrase "amortizable bond premium" is reasonable.

BLEED THROUGH POOR COPY

14. In disregarding and invalidating Treasury Regulations 111, Section 29.125-5 which not only include convertible and callable bonds but specifically provide that "a convertible bond is within the scope of Section 125 if the option to convert on a date certain specified in the bond rests with the holder thereof."

15. In holding inferentially that the amount of amortizable bond premium must be computed in some undisclosed and unstandardized manner not specifically prescribed in the statute or Treasury Regulations.

16. In misconstruing the language contained in the Ways and Means Committee's Report that convertible bonds are entitled to the benefit of the "amortizable bond premium" of the tax statute.

17. In finding that the stock purchase option contained in the bond could be exercised by the bondholder at once, when, in fact, the bonds were issued under an indenture dated September 1, 1941, which provided that unless previously called for redemption, the option could be exercised only after January 1, 1942, and between that date and December 31, 1954. (R. 23.)

18. In superimposing its own idea of legislative policy through the guise of judicial process.

19. In creating rather than finding doubts with respect to the scope and meaning of the statutes involved and then resolving those doubts against the petitioners, as taxpayers, when such doubts, if any, should be resolved in their favor.

E. SUMMARY OF THE ARGUMENT.

(1) Under the provisions of the Internal Revenue Code, petitioners are entitled to amortize or deduct premiums paid by them upon the bonds purchased. (2) The right to amortize or deduct the aforementioned premiums rests not only upon the letter of the code provisions, but also upon the obvious intent of the basic statute. (3) The statutory right is recognized in the regulations issued by the Commissioner in pursuance of the code section. (4) Section 125 of the Internal Revenue Code declares unambiguously the precise rules for the determination of the existence of bond premium and the amount thereof. (5) Since the bond premium amortized or deducted by petitioners is squarely within the provisions of Sections 23(v) and 125 of the Revenue Code, the Court's statement that deductions are matters of "legislative grace" and "are to be strictly construed against the taxpayer" are not applicable to this case. (6) The Court of Appeals erroneously adopted the Commissioner's strained construction of the statutory language with respect to limiting the amortizable bond premium to the interest factor alone. (7) The Court of Appeals erroneously adopted the Commissioner's esoteric concept of "true bond premium" which has been previously rejected by this Court. (8) The Tax Court having held that the amount above par paid for the bonds was bond premium the Court of Appeals was not at liberty to draw a contrary inference that such amount was paid solely for a stock purchasing covenant. (9) The amount of the bond premium amortized by each of the petitioners respectively shows substantial if not exact compliance

BLEED THROUGH POOR COPY

with the terms of Section 125 of the Code, and is therefore fully deductible under Section 23(v) thereof. (10) The decision of the Court of Appeals is a judicial attempt to remodel legislation and trespasses beyond the judicial and upon the legislative process.

F. ARGUMENT.

1. UNDER THE PROVISIONS OF THE INTERNAL REVENUE CODE, PETITIONERS ARE ENTITLED TO AMORTIZE OR DEDUCT PREMIUMS PAID BY THEM UPON THE BONDS PURCHASED.

The pertinent provisions of the Tax Statute and Regulations have been set out in full in the opinion of the Court of Appeals. (R. 62-65.) It should be sufficient to direct attention to the particular provisions that are determinative of the issues in this case.

> The term "bond" as used in the Code is defined as "* * * *any bond*, debenture, note, or certificate or other evidence of indebtedness." etc. (Section 125 (d).)

There is expressly *excluded* from the definition of the term "bond"

> "* * * any such obligation which constitutes stock in trade of the taxpayer or any such obligation of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or any such obligation held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

It was stipulated in the Tax Court in the light of the foregoing provision that:

> "17. The bonds purchased by petitioners, Joe Shoong and Rose Shoong, were not part of the stock in trade of the petitioners, or includible in any inventory of the petitioners at the close of the taxable years, or held by the petitioners primarily for sale to customers in the ordinary course of their trade or business. Petitioners did not, during the calendar year 1944, sell any of the bonds purchased by them, as aforesaid, nor did they exercise their privilege of converting said bonds into capital stock of the company." (R. 28, 29.)

The phrase, "any bond," etc. appearing in the first portion of Subdivision (d), is all-inclusive and therefore includes callable and convertible bonds. The exclusion clause in the latter part of Subdivision (d) contains no express reference to callable or convertible bonds as such, and since particular expressions are limited in their qualification of general expressions, we urge that the general definition of the term "bond" in the first part of Subdivision (d) is expressly limited by the qualification appearing in the latter portion of said subdivision.

The duty rested upon Congress to determine the nature and extent of the qualification or exception to the term "bond", and since Congress did not include in the qualification or exception "callable or convertible bonds", that fact raises a conclusive presumption that Congress did not intend to make them such exception, and it is not the province of the Court to do so.

Wabash R. R. Co. v. U. S. (8th Cir.), 178 F. 5, 11;

BLEED THROUGH POOR COPY

U. S. v. Pan American etc. (9th Cir.), 55 F. (2d) 758, 772.

Since the latter portion of Subdivision (d) is designed to be an exception, the maxim, "*expressio unius est exclusio alterius,*" applies. It is a well settled principle of statutory construction that the expression of one thing excludes others not expressed.

Jones, Collector of Internal Revenue v. Crosswell (4th Cir.), 60 F. (2d) 827, at 828.

To extend the qualifying exception in the latter part of Subdivision (d) by including callable and convertible bonds would violate the cardinal rule of statutory construction which requires exceptions to be strictly construed.

Midland v. Ickes (8th Cir.), 125 F. (2d) 618, at 625-6.

In the interpretation of tax statutes it is the established rule *not* to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out and *in case of doubt, such statutes must be construed strictly in favor of the taxpayer.*

Gould v. Gould, 245 U.S. 151, 153, 38 S. Ct. 53, 62 L. Ed. 211, 213;

United States v. Merriam, 263 U.S. 179, 187, 44 S. Ct. 69, 68 L. Ed. 240, 244;

Hecht v. Malley, 265 U.S. 144, 44 S. Ct. 462, 68 L. Ed. 949, 957.

2. **THE RIGHT TO AMORTIZE OR DEDUCT THE AFOREMENTIONED PREMIUM RESTS NOT ONLY UPON THE LETTTER OF THE CODE PROVISIONS, BUT ALSO UPON THE OBVIOUS INTENT OF THE BASIC STATUTE.**

Both the House and Senate Committee Reports in connection with the Revenue Act of 1942, which added Sections 23(v) and 125 to the Code, affirmatively set forth that:

> "The fact that a bond is callable or convertible into stock does not of itself prevent the application of this section. In the case of a callable bond, the earliest call date will, for the purposes of this section, be considered as the maturity date. Hence, the total premium is required to be spread over the period from the date as of which the basis of the bond is established down to the earliest call date, rather than down to the maturity date. *In the case of a convertible bond, if the option to convert the bond into stock rests with the owner of the bond, the bond is within the purview of this section.*" (Emphasis added.)
>
> H. Rep. No. 2333, 77th Cong., 2d Sess., p. 80 (1942-2 CB 372, 433-434);
>
> S. Rep. No. 1631, 77th Cong., 2d Sess., p. 94 (1942-2 CB 504, 576).

The final statement in the foregoing reports "is unequivocal and precisely includes the bonds in controversy." (*In re Korell*, Tax Court Opinion 10 T.C. 1001.)

Under Section 125(b)(1) of the Code, the amount of the bond premium to be amortized is the difference between the cost or basis and

> "* * * the amount payable on maturity or on earlier call date."

BLEED THROUGH POOR COPY

As stated in the Summary and Short Statement Of The Matter Involved, the bonds were subject to call at any time on or after September 1, 1942, and to and including August 31, 1953, on thirty days' notice of desire to exercise the right to redeem. Accordingly, the earliest call date with respect to any bonds purchased by the respondents in 1944 was thirty days from the purchase, and the bond premium therefore was to be amortized over the thirty day period.

There can be no doubt that the statute as finally enacted by the Congress incorporates the legislative intent as reflected by the House and Senate Committee Reports, all as expressed in the portion above quoted, by providing without equivocation that the rules prescribed by Section 125 apply not only to all bonds coming within the definition of the term as outlined in Subdivision (d), but as well apply in the case of "any bond" as outlined in Subdivision (a), and likewise apply "in the case of the holder of any bond" as outlined in Subdivision (b)(1). (R. 62.)

In *Broadcasting etc. Inc. v. Federal Communications Commission* (Dist. of Col.), 171 F. (2d) 1007, 1010, the Court reaffirmed the principle that the most accurate guides for determining legislative intent and purpose

> "* * * are the words themselves which were enacted into law, provided those words are unambiguous and unequivocal"

and when language of a statute meets these tests it becomes

> "* * * not only the privilege but the duty of this court"

to interpret such statute accordingly.

In *Algoma Plywood etc. Co. v. Wisconsin Employment Relations Board*, 93 L. Ed. Adv. Op. 541, Mr. Justice Frankfurter, speaking for a majority of the Court, declared that Courts are not justified in rejecting legislative interpretation of a statute placed upon it at the time of its enactment, nor to adopt a construction in disregard of legislative history.

In *Ex parte Collett*, 93 L. Ed. Adv. Op. 901, 903, the Court said

> "• • • there is no need to refer to the legislative history where the statutory language is clear. 'The plain words and meaning of a statute cannot be overcome by a legislative history, which through strained processes of deduction from events of wholly ambiguous significance, may furnish dubious bases for inference in every direction.'"
>
> *Gemsco, Inc. v. Walling*, 324 U.S. 244, 260, 89 L. Ed. 921, 933, 65 S. Ct. 605.

Where the language of a statute is clear and unambiguous, resort to legislative history or artificial canons of construction is unnecessary.

Packard Motor Car Co. v. N.L.R.B., 330 U.S. 485, 492, 67 S. Ct. 789, 91 L. Ed. 1040, 1050;

Brotherhood of R. Trainmen v. Baltimore & O. R. Co., 331 U.S. 519, 528, 529, 67 S. Ct. 1387, 91 L. Ed. 1646;

United States v. Rice, 327, U.S. 742, 753, 66 S. Ct. 835, 90 L. Ed. 982.

Where Congress has made a choice of language which fairly brings a given situation within a statute, it is un-

BLEED THROUGH POOR COPY

important that the particular application may not have been contemplated by the Congress.

Barr v. United States, 324 U.S. 83, 65 S. Ct. 522, 89 L. Ed. 765, 771;

Puerto Rico v. Shell Co., 302 U.S. 253, 257, 58 S. Ct. 167, 82 L. Ed. 235, 240;

Browder v. United States, 312 U.S. 335, 339, 61 S. Ct. 599, 85 L. Ed. 862.

---

3. **THE STATUTORY RIGHT IS RECOGNIZED IN THE REGULATIONS ISSUED BY THE COMMISSIONER IN PURSUANCE OF THE CODE SECTION.**

The Regulations issued in pursuance of the directions contained in Section 125 recognize the right to amortize bond premiums as was here done by the respective petitioners. Section 29.125-5 of Regulations 111 has a heading reading as follows: "Callable and Convertible Bonds." The introductory sentence declares:

> "The fact that a bond is callable or convertible into stock does not, in itself, prevent the application of Section 125."

Later in the same section the following sentence appears:

> "A convertible bond is within the scope of Section 125 if the option to convert on a date certain specified in the bond rests with the holder thereof."

There is no dispute that the bonds were convertible at the option of the holder at any date he chose, commencing with January 2, 1942, and ending with December 31, 1954.

The language of the Regulations 111, Section 29.125-5, is clearly unambiguous, and plain. Notwithstanding this fact, the Court of Appeals took a position completely at variance with the plain significance of the statute and the Regulations.

Of course, the Regulations seek to restrict the application of Section 125 in the case of convertible bonds to bonds conferring the privilege to convert "on a date certain," but this was characterized by the Tax Court in the *Korell* case as "a gratuitous addition" on the part of the Commissioner,

> "• • • not founded upon the statutory language and directly in conflict with its legislative history." *Commissioner v. Korell* (10 T.C. 1001).

The Court of Appeals in *Commissioner v. Korell*, held that irrespective of whether such language was gratuitous or not, the statute contained no suggestion of the narrowing concept urged by the Commissioner.

It is respectfully submitted that the conclusion reached by the Court of Appeals in the *Korrell* case is correct.

---

4. **SECTION 125 OF THE INTERNAL REVENUE CODE DECLARES UNAMBIGUOUSLY THE PRECISE RULES FOR THE DETERMINATION OF THE EXISTENCE OF BOND PREMIUM AND THE AMOUNT THEREOF.**

In each of the notices of deficiency sent to the petitioners by the Commissioner the deductions claimed were disallowed in the following language:

BLEED THROUGH POOR COPY

> "The deduction is disallowed since it is held that the amount does not represent amortizable bond premium. *It is held that the consideration represents the value of the right to convert the bonds into capital stock of the company.*" (Emphasis ours.) (R. 9 and 18.)

In other words, the respondent claims and the Court of Appeals has held that the petitioners should be denied the right to amortize the premiums admittedly paid for the bonds because of the "conversion privilege acquired with the bonds." The answers to such contention have already been supplied in the earlier portions of this brief, and may be recapitulated as follows:

(a) Convertible bonds were not excluded from the definition of "bonds" under the Code.

(b) Both the Senate and House Committee Reports affirmatively disclose such bonds were intended to be included.

(c) The Regulations promulgated by the Commissioner specifically and clearly, state that convertible bonds are within the scope of the Code provisions.

The plain and unambiguous definition of "bond premium" as set forth in the Code must prevail even though the Court of Appeals held that (R. 69)

> "* * * Congress was solely concerned with the interest factor of the bonds * * *"

The simple language of the statute supplies the most forceful reply to the Court's ruling. Subdivision (b)(1) of Section 125 declares that the amount of the bond premium

> "• • • shall be determined with reference to the amount of the basis • • • of such bond and with reference to the amount payable on maturity or on earlier call date."

The word "basis" of course means "cost".

The simplicity of the foregoing language gave birth to equally simple language which the Commissioner placed in his Regulations 111 (Section 29.125-2) as follows:

> "Bond premium on any bond to which Section 125 applies *is* the excess of the amount of the basis (for determining loss on sale or exchange) of the bond over the amount payable at maturity or, in the case of a callable bond, earlier call date." (Emphasis ours.)

What more is needed to clarify that which is already crystal clear, unless it be to put a polish upon the transparent surface of plain language. This function may be performed by a further excerpt from the Reports of the House Ways aand Means Committee and the Senate Finance Committee, accompanying the Revenue Act of 1942, which reads:

> *"Bond premium, in the case of any bond subject to this section, IS the total premium thereon;* that is, the excess of the basis of the bond for determining loss over the amount payable at maturity. On the other hand, amortizable bond premium is such part of the total premium on the bond as is attributable to the taxable year." (Emphasis ours.)
>
> H. Rep. No. 2333, 77th Cong., 2d Sess., p. 79 (1942-2 CB 372, 432); S. Rep. No. 1631, 77th Cong., 2d Sess., p. 93 (1942-2 CB 504, 574-575).

BLEED THROUGH POOR COPY

The practical effect of the Court of Appeals' decision is to sweep all this aside, since it holds, in effect, that the amortizable bond premium refers only to the premium paid for a high interest rate and that the statute does not authorize the deduction of such premium if the bond has a convertible feature attached to it. There is no language in the tax statute which supports, either expressly or impliedly, the conclusion reached by the Court of Appeals.

The Court of Appeals states that while Section 125 provides for an "amortizable bond premium" yet "it does not purport to define that phrase." We see no justification for such statement by the Court of Appeals in the light of the language of Section 125 (b) with its three separate subdivisions and their significant headings.[1] This statement becomes even more amazing in the light of the attitude taken by the Commissioner which is reflected by

---

[1](b) **Amortizable bond premium.**—

(1) **Amount of bond premium.**—For the purposes of paragraph (2), the amount of bond premium, in the case of the holder of any bond, shall be determined with reference to the amount of the basis (for determining loss on sale or exchange) of such bond, and with reference to the amount payable on maturity or on earlier call date, with adjustments proper to reflect unamortized bond premium with respect to the bond, for the period prior to the date as of which subsection (a) becomes applicable with respect to the taxpayer with respect to such bond.

(2) **Amount amortizable.**—The amortizable bond premium of the taxable year shall be the amount of the bond premium attributable to such year.

(3) **Method of determination.**—The determinations required under paragraphs (1) and (2) shall be made—

(A) in accordance with the method of amortizing bond premium regularly employed by the holder of the bond, if such method is reasonable;

(B) in all other cases, in accordance with regulations prescribing reasonable method of amortizing bond premium, prescribed by the Commissioner with the approval of the Secretary.

the statement appearing in his petition for writ of certiorari in *Commissioner v. Korell,* wherein he states,

> "Section 23(v) merely included among the authorized deductions from gross income the allowance for 'amortizable bond premium' provided in Section 125. *The latter section, in turn, defined 'amortizable bond premium,'* fixed the amount allowable in any taxable year, prescribed the method of determination of the amount deductible, and made other and detailed provisions with respect to the allowance."

It should require little citation of authority to support the well-known principle that the intention of Congress is to be sought for primarily in the language used, and where this expresses an intention reasonably intelligible and plain, it must be accepted without modification by resort to construction or conjecture.

Thompson v. U. S., 246 U. S. 547, 62 L. Ed. 876; 38 S. Ct. 349;

Caminetti v. U. S., 242 U. S. 470, 61 L.Ed. 442, 453; 37 S. Ct. 192;

In re Borchert (Cal.), 47 F. Supp. 387, 390;

Federal Savings & Loan Ins. Corp. v. Edison Savings & Loan Ass'n. (N. Y.), 83 F. Supp. 1007.

The Courts are not at liberty to construe language so plain as to need no construction, or to refer to committee reports where there can be no doubt of the meaning of the words used.

Helvering v. City Bank etc. Co., 296 U.S. 85, 80 L. Ed. 62, 66, 56 S. Ct. 70.

The Congressional intent must be controlling in the construction of federal statutes, *and it is only in the*

BLEED THROUGH POOR COPY

absence of an express or an implied intent that judicial construction may be resorted to.

McKeown v. So. Cal. etc. Forwarder (Cal.), 52 F. Supp. 331; affirmed 148 F. (2d) 840; cert. denied, 326 U.S. 736, 90 L. Ed. 439, 66 S. Ct. 46; rehearing denied, 326 U. S. 808, 90 L. Ed. 493, 66 S. Ct. 138.

See also:

Forrestal v. Commissioner (2d Cir.), 120 F. (2d) 223, 225;

Osaka etc. Line v. U. S., 300 U.S. 98, 81 L.Ed. 532, 57 S.Ct. 356.

---

5. SINCE THE BOND PREMIUM AMORTIZED OR DEDUCTED BY PETITIONERS IS SQUARELY WITHIN THE PROVISIONS OF SECTIONS 23(v) AND 125 OF THE REVENUE CODE, THE APPELLATE COURT'S STATEMENT THAT DEDUCTIONS ARE MATTERS OF "LEGISLATIVE GRACE" AND "ARE TO BE STRICTLY CONSTRUED AGAINST THE TAXPAYER" ARE NOT APPLICABLE TO THIS CASE.

We have shown that under the specific provisions of the Internal Revenue Code, petitioners are authorized to amortize or deduct the premium paid by them for callable or convertible bonds.

Unquestionably Congress has the power to condition, limit or deny deductions (*Burnet v. Thompson Oil & Gas Co.*, 283 U. S. 301, 304, 51 S. Ct. 418, 75 L. Ed. 1049, 1052) but once having granted such deduction, the taxpayer has only to point to the applicable statute and show that he comes within its terms.

New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440, 54 S. Ct. 788, 790, 78 L. Ed. 1348;

Commissioner v. Riggs (CCA 3), 78 F. (2d) 1004, 1005.

The deduction or amortization in this case, being plainly authorized by the provisions of the Internal Revenue Code, there is no need for construction, strict or otherwise and the statement of the Court of Appeals that deductions are matters of legislative grace and are to be strictly construed has no bearing.

---

6. **THE COURT OF APPEALS ERRONEOUSLY ADOPTED THE COMMISSIONER'S STRAINED CONSTRUCTION OF THE STATUTORY LANGUAGE WITH RESPECT TO LIMITING THE AMORTIZABLE BOND PREMIUM TO THE INTEREST FACTOR ALONE.**

The Court of Appeals, asserting that it was relying upon House Report No. 2333, 77th Cong., 1st Session (Cum. Bull., 1942-2, 372, 410) held that the Congressional intent in creating the amortizable bond premium deduction referred solely to the interest provision of the bond and sought to support its holding by pointing out that since the word "interest" alone appears in the definition of a bond (Section 125 sub. (d)) the inference was that Congress was solely concerned with the amortization or deduction of premiums paid with respect to the interest factor of the bond only.

Since every bond is an evidence of indebtedness bearing interest, the Court of Appeals' conclusion based upon such definition is without merit. Moreover, assuming for purposes of argument only, that amortizable bond premium refers to the interest factor alone, then what is meant by "interest?"

Since Congress did not define the term "interest" the rule is that it used the word in its known and ordinary

BLEED THROUGH POOR COPY

significance, which in this case was "what is usually called interest by those who pay and those who receive the amount so denominated in bond and coupon." (*Old Colony R. Co. v. Commissioner*, 284 U.S. 552, 560, 52 S. Ct. 211, 76 L. Ed. 484; *Consolidated Goldacres Co. v. Commissioner* (CCA 10), 165 F. (2d) 542, 545).

In common understanding "bond premium" is "the amount by which the issue price or cost at a later date exceeds maturity value."[1] While the interest factor, namely the condition of the money market, is an element that influences bond premiums, it is not the sole or even the most important factor. It is well known that there are a number of other factors which determine bond premium such as (a) the credit standing of the issuing company, (b) the security of the bond issue, (c) whether such bond is convertible or redeemable, and if so, the time element involved, and (d) the redemption price.[2] Since all these and, at times, other factors operate in the open market to determine bond premium, the Court of Appeals erred in holding that the term "amortizable bond premium" refers to only one of these factors, to-wit, the interest factor, to the exclusion of all others. The statute does not provide nor do the regulations declare that the factors which determine bond premium must be segre-

---

[1]Advanced Accounting, W. A. Patton, The Macmillan Company, N. Y. 1941, pp. 196-7, 614.

American Business Practice, The Ronald Press Company, N. Y. 1931, p. 1653.

Accounting Principles, 4th Ed., Howard S. Noble, Southwestern Publishing Co., Cincinnati, Ohio, 1945, p. 447.

[2]Financial Handbook, 3rd Ed., Jules I. Bogen, The Ronald Press Company, N. Y. 1948, pp. 1210-11.

Basic Accounting Principles, Earl L. Saliers, Richard D. Irwin, Inc., Chicago, 1947, pp. 508-9.

gated nor is there any formula or procedure for making such segregation or determination of that portion of the total bond premium which shall be allocated to each of the foregoing factors or any other factors which may be present.

The actual interest yield on 3% bonds of $100 par value purchased at $120, is 2½% or less, depending on the period over which the taxpayer is required or permitted to amortize bond premium, and *not* 3% as determined by the Court of Appeals in disallowing any deduction for amortization. Inasmuch as the Court of Appeals adopted the Commissioner's strained construction that the amount of amortizable bond premium was the difference between the yield and the actual interest rate, it follows that even considering the interest factor alone, the taxpayers actually did pay a bond premium as so defined and therefore were entitled to amortize the amount thereof as determined by and computed in accordance with the tax statute and Regulations.

---

7. THE COURT OF APPEALS ERRONEOUSLY ADOPTED THE COMMISSIONER'S ESOTERIC CONCEPT OF "TRUE BOND PREMIUM" WHICH HAS BEEN PREVIOUSLY REJECTED BY THIS COURT.

The Court of Appeals adopted the Commissioner's contention, namely, that the proper procedure was to amortize not the excess of the basis of the bond for determining loss over the amount payable at maturity or earlier call date, which is commonly called bond premium (H. Rep. No. 2333, 77th Cong., 2d Sess., p. 79 (1942-2 CB 372, 432); S. Rep. No. 1631, 77th Cong., 2d Sess., p. 93 (1942-2 CB

BLEED THROUGH POOR COPY

504, 574-575), but a different sum to be ascertained by an undisclosed and abstruse calculation which is supposed to allocate the bond premium between the convertible feature of the bond and the Commissioner's concept of "true bond premium," to-wit, the difference between the yield and the actual interest rate.

However, this Court in *Old Colony R. Co. v. Commissioner*, 284 U.S. 552, 560, 52 S. Ct. 211, 76 L. Ed. 484, 489, refused to adopt such "esoteric concept derived from subtle and theoretic analysis" when the Commissioner similarly contended that a taxpayer could not deduct from his gross income the amount agreed to be paid as interest, but only a different sum calculated so as to allocate the payment of interest between "effective" or "true interest" and a partial or ratable return of "true bond premium."

This Court held in the *Old Colony* case that the term "interest" could not be broken down into two components, to-wit, "true interest" and "bond premium." It follows, therefore, that the term "bond premium" cannot be separated into two components, to-wit, "interest" and "true bond premium." There is, consequently, no basis for placing the strained construction upon the statute or for subjecting the term "amortizable bond premium" to subtle and theoretic analysis.

Commissioner v. Columbia River P. Mills (CCA 9), 126 F. (2d) 1009, 1010;

Commissioner v. Proctor Shops, Inc. (CCA 9), 82 F. (2d) 792;

Commissioner v. T. R. Miller Mill Co. (CCA 5), 102 F. (2d) 599.

8. THE TAX COURT HAVING HELD THAT THE AMOUNT ABOVE PAR PAID FOR THE BONDS WAS BOND PREMIUM THE COURT OF APPEALS WAS NOT AT LIBERTY TO DRAW A CONTRARY INFERENCE THAT SUCH AMOUNT WAS PAID SOLELY FOR A STOCK PURCHASING COVENANT.

The holding of the Tax Court was that the amount above par paid by the taxpayer was a bond premium. Therefore, the Court of Appeals was not permitted to draw a contrary inference, to-wit, that the amount above par paid for the bonds was paid solely for the stock purchasing covenant.

The initial function of drawing inferences is for the Tax Court, rather than for the Court of Appeals on petition for review, even from stipulated facts.

Raffold Process Corp. v. Commissioner (CCA 1), 153 F. (2d) 168;

Boehm v. Commissioner, 326 U.S. 287, 294, 66 S.Ct. 120, 90 L.Ed. 78, 84.

If opposing inferences reasonably may be drawn from undisputed facts, the judgment of the Tax Court as to what inferences shall be drawn is controlling.

Tyson v. Commissioner (CCA 8), 146 F. (2d) 50;

Jones v. Commissioner (CCA 9), 103 F. (2d) 681;

Elmhurst Cemetery Co. v. Commissioner, 300 U.S. 37, 40, 57 S.Ct. 324, 81 L.Ed. 491.

Great weight and consideration should be accorded to decisions of the Tax Court.

Commissioner v. Midland Elec. Coal Corp. (CCA 7), 152 F. (2d) 171;

Hall v. Commissioner (CCA 10), 150 F. (2d) 304;

Barnhill v. Commissioner (CCA 4), 148 F. (2d) 913;

BLEED THROUGH POOR COPY

Armstrong v. Commissioner (CCA 10), 143 F. (2d) 700, 701;

Dobson v. Commissioner, 320 U.S. 489, 64 S.Ct. 239, 88 L.Ed. 248.

---

9. THE AMOUNT OF THE BOND PREMIUM AMORTIZED BY EACH OF THE PETITIONERS RESPECTIVELY SHOWS SUBSTANTIAL IF NOT EXACT COMPLIANCE WITH THE TERMS OF SECTION 125 OF THE CODE, AND IS THEREFORE FULLY DEDUCTIBLE UNDER SECTION 23 (v) THEREOF.

The Stipulation of Facts in this case (R. 20) makes manifest that the petitioners have complied with all statutory requirements, which compliance may be epitomized as follows:

(1) Subsection (a)(1) of Section 125 requires that bond interest be fully taxable.

Interest on the bonds was fully taxable, and the requirement of this subsection was therefore fulfilled.

(2) Subsection (b)(1) requires that in determining the bond premium the holder of "any bond" must use the basis "(for determining loss on sale or exchange)" of such bond and the amount payable at the maturity or earlier call date.

Fulfilling this requirement, (a) Joe Shoong used the difference between the purchase price of $601,879.94 (his basis for determining loss) and the earliest call date price of $520,000.00 as the bond premium, thus leaving the balance of $81,879.94 for amortization, and (b) Rose Shoong used the difference between the purchase price of $605,607.29 (her basis for determining loss) and the

earliest call date price of $520,000.00 as the bond premium, thus leaving the balance of $85,607.29 for amortization.

(3) Subsection (b)(2) defines "amortizable bond premium" as the "amount of the bond premium attributable to such year," meaning the taxable year.

Each of the petitioners purchased all of his or her bonds in 1944, and the earliest call date was in 1944. It follows, therefore, that the entire premium was amortizable in conformity with the foregoing provision in the taxable year 1944.

(4) Subsection (b)(3) provides that one method of computing amortizable bond premium in addition to the method which may be employed by the holder of the bond, was such method which may be prescribed by the Commissioner.

Each of the petitioners followed precisely the method prescribed by the Commissioner in Regulations 111, Section 29.125-5.

(5) Subsection (c)(2) directs that if the taxpayer makes an election with respect to any bond,

> "* * * it shall also apply to all such bonds held by the taxpayer at the beginning of the first taxable year to which the election applies."

The petitioners purchased in 1944 the bonds in question and sought to amortize the bond premium on "all such bonds."

(6) Subsection (d) was designed to deny to security dealers and traders the opportunity of computing bond

BLEED THROUGH POOR COPY

premium amortization under Section 125 on bonds held as "stock in trade" primarily for sale to customers in the ordinary course of trade or business.

It was stipulated as to each of the petitioners under Paragraph 17 of the Stipulation of Facts (R. 28) that neither of the petitioners was a security dealer or trader.

The Court of Appeals neither found nor held that the transactions were illegal on the ground that they were entered into for tax saving purposes or that by virtue thereof the taxpayers should be denied the right of amortizing the bond premium. The tax statute does not prohibit such transactions.

Under these circumstances, it has been held that the right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted.

Sampson Tire etc. Corp. v. Rogan (9th Cir.), 136 F. (2d) 345, 347;

Commissioner v. Eldridge (9th Cir.), 79 F. (2d) 629, 631;

National Carbide v. Commissioner, 93 L. Ed. Adv. Op. 634, affirming *Commissioner v. National Carbide*, 167 F. (2d) 304, 307 (CCA 2);

Gregory v. Helvering, 293 U.S. 465, 469, 55 S. Ct. 266, 79 L. Ed. 596;

Superior Oil Co. v. Mississippi, 280 U.S. 390, 395, 50 S. Ct. 169, 74 L. Ed. 504;

Murchie v. Delaney, 82 F. Supp. 176 (Mass.).

All other facts to which the Court of Appeals makes reference are immaterial to the issues of this case. The

petitioners contend that the primary question is one of statutory construction, as was admitted by the Commissioner, and it therefore becomes immaterial whether the bond premium is a "true bond premium" or not, with the Commissioner setting himself up as the one to determine what is true and what is not true.

As indicated, Congress undertook to determine by statute what was to be regarded as an "amortizable bond premium", and so long as Congress spoke clearly, it is not the function of either the Commissioner or the Court to enlarge upon Congressional language, by a standard which is personal to the Commissioner and not even suggested in his Regulations, or which may be personal to the individual members of a specific circuit of a Court of Appeals.

---

10. THE DECISION OF THE COURT OF APPEALS IS A JUDICIAL ATTEMPT TO REMODEL LEGISLATION AND TRESPASSES BEYOND THE JUDICIAL AND UPON THE LEGISLATIVE PROCESS.

The Court of Appeals in *Commisioner v. Korell* pointedly observed that to avoid the result complained of by the Commissioner would involve "a judicial attempt to remodel legislation" and to make the distinctions urged by the Commissioner would be "trespassing beyond the judicial, and upon the legislative process."

It is the duty of a court to apply a tax statute as it finds it, leaving to Congress the correction of asserted inconsistencies and inequalities in its operation.

McClain v. Commissioner, 311 U.S. 527, 530, 85 L. Ed. 319, 322, 61 S. Ct. 375;

BLEED THROUGH POOR COPY

Stokes v. Commissioner, 124 F. (2d) 335, 339 (CCA 3);

Commissioner v. Caulkins, 144 F. (2d) 482, 484 (CCA 6).

It is not a court's function to engraft upon a statute additions which it thinks the legislature might or should have made.

United States v. Cooper Corp., 312 U.S. 600, 605, 85 L. Ed. 1071, 1076, 61 S. Ct. 742;

Forstmann v. Rogers, 128 F. (2d) 126, 129 (CCA 3);

Iselin v. United States, 270 U.S. 245, 250-1, 70 L. Ed. 566, 569-70, 46 S. Ct. 248.

Where the words of a statute are plain, a court is not at liberty to add to or alter them to effect a purpose which does not appear on its face or which varies from its legislative history.

Matson Navigation Co. v. United States, 284 U.S 352, 356, 76 L. Ed. 336, 340, 52 S. Ct. 152;

Corona Coal Co. v. United States, 263 U.S. 537, 540, 68 L. Ed. 431, 433, 44 S. Ct. 156.

The courts have no function of legislation, but must simply seek to ascertain the will of the legislature and give effect to plain congressional intent manifested in statutes.

United States v. Goldenberg, 168 U.S. 95, 103, 18 S. Ct. 3, 4, 42 L. Ed. 394;

Ebert v. Poston, 266 U.S. 548, 45 S. Ct. 188, 190, 69 L. Ed. 435, 438;

Koster v. Turchi, 173 F. (2d) 605, 607 (CCA 3).

To permit the decision in this case to become law, is to put the stamp of approval on judicial remodeling of legislation and the invasion of the judicial upon the legislative process.

G. CONCLUSION.

It is respectfully submitted that the Tax Court in this case and the Court of Appeals in *Commissioner v. Korell*, interpreted the statute and the Regulations correctly and that the decision of the Court of Appeals in this case should be reversed.

Dated, San Francisco, California,
November 7, 1949.

Respectfully submitted,
NAT SCHMULOWITZ,
PETER S. SOMMER,
SIDNEY F. DEGOFF,
GAVIN MCNAB, SCHMULOWITZ, AIKINS,
WYMAN & SOMMER,
Attorneys for Petitioners,
Joe Shoong and Rose Shoong.